



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9639]

RIN 1545-BK13

Modifications of Certain Derivative Contracts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the transfer or assignment of certain derivative contracts. The final regulations provide guidance to the nonassigning counterparty to a derivative contract and an assignee on certain notional principal contracts that are derivative contracts. The final regulations provide that the nonassigning counterparty does not have an exchange for purposes of §1.1001-1(a) when certain derivative contracts are transferred or assigned and clarify that the embedded loan rules of §1.446-3(g)(4) do not apply to such transactions.

DATES: Effective Date: These regulations are effective on **[INSERT DATE THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER]**.

Applicability Date: For the date of applicability, see §1.1001-4(d).

FOR FURTHER INFORMATION CONTACT: Andrea M. Hoffenson, (202) 622-3920 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1. On July 22, 2011, temporary regulations (TD 9538) relating to the effect of the transfer or assignment of certain derivative contracts under section 1001 of the Internal Revenue Code (Code) were published in the **Federal Register** (76 FR 43892). A notice of proposed rulemaking (REG-109006-11) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (76 FR 43957). A correction to the temporary regulations was published on August 19, 2011, in the **Federal Register** (76 FR 51878). No public hearing was requested or held. No written or electronic comments responding to the notice of proposed rulemaking were received. The proposed regulations are adopted as amended by this Treasury decision, and the corresponding temporary regulations are removed.

Section 1001 provides rules for the computation and recognition of gain or loss from a sale or other disposition of property. For purposes of section 1001, §1.1001-1(a) of the Income Tax Regulations generally provides that gain or loss is realized upon an exchange of property for other property differing materially either in kind or in extent. As a general matter, the assignment of a derivative contract is treated as a taxable disposition to a nonassigning counterparty if the resulting contract differs materially either in kind or in extent. See Cottage Savings Association v. Commissioner, 499 U.S. 554, 566 (1991) [1991-2 CB 34, 38] (“Under [the Court’s] interpretation of [section] 1001(a), an exchange of

property gives rise to a realization event so long as the exchanged properties are ‘materially different’--that is, so long as they embody legally distinct entitlements.”). The temporary regulations provide, however, that the transfer or assignment of a derivative contract by a dealer or clearinghouse to another dealer or clearinghouse is not treated as a deemed exchange of the contract by the nonassigning counterparty for purposes of §1.1001-1(a) provided that the transfer or assignment is permitted by the terms of the contract and the terms of the contract are not otherwise modified.

Explanation of Revisions

The final regulations adopt the general rule in the temporary regulations providing that a transfer or assignment of a derivative contract that satisfies the conditions specified in the regulations is generally not treated by the nonassigning counterparty as a deemed exchange of the original contract under §1.1001-1(a). As explained below, a sentence has been added to the final regulations to clarify that a loan is not created when a notional principal contract (NPC) is transferred or assigned under the conditions specified in these final regulations.

In general, §1.446-3(h) provides rules that prescribe the treatment of a termination payment made or received by the assignor or assignee pursuant to an assignment of an NPC, while the consequences to the nonassigning counterparty are governed by section 1001. A termination payment made or received on an NPC is treated by the assignee as a nonperiodic payment under §1.446-3(h)(3). See §1.446-3(h)(5), Example 2. In addition, §1.446-3(h)(3)

makes the special rules of §1.446-3(g)(4) applicable to a termination payment made pursuant to an NPC. Section 1.446-3(g)(4) generally provides that a swap with significant nonperiodic payments is treated as two transactions, an on-market, level payment swap and a loan.

These final regulations expressly provide that a payment between the party transferring or assigning its rights and obligations under the contract and the party to which the rights and obligations are transferred or assigned pursuant to the transfer or assignment of an NPC that meets the conditions specified in these regulations is not subject to the embedded loan rules in §1.446-3(g)(4). Thus, neither the assignee nor the nonassigning counterparty is treated as having an embedded loan under §1.446-3(g)(4) as a result of a payment made between the assignor and the assignee of an NPC pursuant to a transfer or assignment that satisfies the requirements of §1.1001-4(a). The Treasury Department and the IRS believe that it would be inconsistent for an embedded loan to result from such a payment in circumstances in which the general rule in §1.1001-4(a) treats the transfer or assignment of an NPC as not creating a taxable event for the nonassigning counterparty.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the

regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

Drafting Information

The principal author of these regulations is Andrea M. Hoffenson, Office of Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.1001-4 is revised to read as follows:

§1.1001-4 Modifications of certain derivative contracts.

(a) Certain assignments. For purposes of §1.1001-1(a), the transfer or assignment of a derivative contract is not treated by the nonassigning

counterparty as a deemed exchange of the original contract for a modified contract that differs materially either in kind or in extent if--

(1) Both the party transferring or assigning its rights and obligations under the derivative contract and the party to which the rights and obligations are transferred or assigned are either a dealer or a clearinghouse;

(2) The terms of the derivative contract permit the transfer or assignment of the contract, whether or not the consent of the nonassigning counterparty is required for the transfer or assignment to be effective; and

(3) The terms of the derivative contract are not otherwise modified in a manner that results in a taxable exchange under section 1001.

(b) Definitions--(1) Dealer. For purposes of this section, a dealer is a taxpayer who meets the definition of a dealer in securities in section 475(c)(1) or is a dealer in commodities derivative contracts.

(2) Clearinghouse. For purposes of this section, a clearinghouse is a derivatives clearing organization (as such term is defined in section 1a of the Commodity Exchange Act (7 U.S.C. 1a)) or a clearing agency (as such term is defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a))) that is registered, or exempt from registration, under each respective Act.

(3) Derivative contract. For purposes of this section, a derivative contract is a contract described in--

(i) Section 475(c)(2)(D), 475(c)(2)(E), or 475(c)(2)(F) without regard to the last sentence of section 475(c)(2) referencing section 1256;

(ii) Section 475(e)(2)(B), 475(e)(2)(C), or 475(e)(2)(D); or

(iii) Section 1.446-3(c)(1).

(c) Consideration for the assignment. Any payment between a party transferring or assigning its rights and obligations under the contract and the party to which the rights and obligations are transferred or assigned pursuant to a transfer or assignment described in paragraph (a) of this section will not affect the treatment of the nonassigning counterparty for purposes of this section. A payment described in the preceding sentence made or received to transfer or assign rights and obligations under a notional principal contract (as defined in §1.446-3(c)(1)) is not subject to §1.446-3(g)(4).

(d) Effective/applicability date. This section applies to transfers or assignments of derivative contracts on or after July 22, 2011.

§1.1001-4T [Removed]

Par. 3. Section 1.1001-4T is removed.

Heather C. Maloy
Acting Deputy Commissioner for Services and Enforcement.

Approved: October 29, 2013

Mark Mazur
Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2013-26575 Filed 11/05/2013 at 8:45 am; Publication Date: 11/06/2013]